KWALITY TEXTILES (M) SDN. BHD.

v.

SP ARUNACHALAM SUBRAMANIAM CHETTIAR & ORS.

SUPREME COURT, KUALA LUMPUR
HASHIM YEOP SANI CJ (MALAYA)
HARUN HASHIM SCJ
MOHD. YUSOFF MOHAMED SCJ
[SC CIVIL APPEAL NO. 02-50-1990]
11 SEPTEMBER 1990

COMPANY LAW: *Transfer of shares to members - Request for rectification of register - Refusal by directors - Absolute discretion under articles of association - General or limited application - Mala fides.*

The respondents R, owned shares in the appellant K; certain shares were transferred to R who requested the directors of K to register them as owners of these shares. The directors of K refused to do so in exercise of their discretion under Article 44(1) of the Articles of Association which provided, *inter alia*, that the directors had absolute discretion to refuse to register any transfer of shares to a person of whom they shall not approve. R then applied to the High Court for rectification of the register of K and were successful. K hence appeals.

The issue before the Court was whether Article 44(1) has a general or limited application.

Held:

[1] There is nothing in law to limit the restrictions which a company's articles may impose on the right of transfer.

[2] It is clear from the language used in Article 44(1) that the discretion is exercisable in respect of any transfer of shares, be it from member to member or member to non-member and the directors may refuse to register any transfer to a person (whether a member or not) of whom they do not approve - *In Re Dublin North City Milling Company* followed.

[3] The Court should not interfere with the proper exercise of discretion of the board of directors conferred by the Articles of Association to refuse registration for the well being of the company; indeed the Court should be slow to question the exercise of the discretion in the absence of evidence that the board of directors had acted *mala fide.*

[Appeal allowed.]

Cases referred to:
In the Matter of Tahansan Sdn. Bhd. [1984] 1 CLJ (Rep) 383
In Re Dublin North City Milling Company [1909] IR 179
Kesar Singh v. Sepang Omnibus Co. Ltd. [1964] 30 MLJ 122
Re Smith & Fawcett Ltd. [1942] 1 All ER 542
Mohan a/l Paramsivam v. Sepang Omnibus Co. Sdn. Bhd. [1989] 1 MLJ 247

Other source referred to:
Palmers' Company Law, Twenty-fourth Edn., p. 616

For the appellant - Cecil Abraham; M/s. Shearn & Delamore
For the respondents - Porres Royan; M/s. Shook Lin & Bok

JUDGMENT

Hashim Yeop Sani CJ (Malaya):

The respondents had by originating summons applied to the High Court for rectification of the register of members of the appellant company, Kwality Textiles (M) Sdn. Bhd. (the company) by having their names registered as owners of certain shares that had been transferred to them. At the time of the transfer of the said shares the respondents were already owners of other shares in the company and therefore were already members of the company.

The directors of the company refused to register the transfer purportedly in exercise of their discretion under Article 44(1) of the Articles of Association of the company. The said Article 44(1) reads as follows:

> 44.(1) The directors may in their **absolute discretion** without assigning any reason refuse to register any transfer of shares to **a person of whom they shall not approve** and they may also refuse to register any transfer of shares on which the company has a lien.
> (Emphasis supplied)

As will be seen later the words emphasised are quite material to the appeal.

After hearing the parties the learned Judge of the High Court ruled in favour of the respondents for reasons set out in his grounds of decision.

The trial Judge framed the principal issue before him thus - does the said Article 44(1) have a general application or is it of limited application? He held that the said Article 44(1) has no general application and in particular has no application to a transfer from a member to another member which is the case here. That issue forms the crux of the grounds of decision and having construed Article 44(1) in the manner he did the learned Judge held that the directors of the company had no discretion to refuse to effect a transfer of shares from one member to another. Since the learned Judge held that there was no discretion to refuse to register the transfer the question of any contravention of the Industrial Coordination Act 1975 becomes a secondary issue. It may also be mentioned in this regard the learned Judge in his grounds of decision said he agreed with the reasoning *In the Matter of Tahansan Sdn. Bhd.* [1984] 1 CLJ (Rep) 383 where Chan J stated that the Court will not countenance the going back on an agreement binding on a company even if thereby there is a real danger of the company losing its manufacturing licence.

The learned Judge here held that Article 44(1) does not apply to transactions to which Article 43 applies. Articles 42 and 43 read as follows:

> 42. If the company shall within the space of 28 days after being served with such notice find a member (hereinafter called the purchasing member) willing to purchase the share and shall give notice to the proposing transferor, he shall be bound, upon payment of fair value, to transfer to the purchasing member.
>
> 43. If the company shall not within the space of 28 days aforesaid find a member willing to purchase the share and give notice in manner aforesaid, the proposing transferor shall at any time within six months afterwards be at liberty to sell and transfer the share to any person at any price.

The first thing to note in a situation like the present one is that there is nothing in law to limit the restrictions which a company's articles may impose on the right to transfer. Shares are a form of property connected with an association of members and in some companies the identity of members of the company may be important and as a result the memorandum

of Articles of the Association of a company may in the interest of all members impose restrictions in the transfer of shares. In *Palmers' Company Law*, 24th Edn. the author says at p. 616:

> There is nothing to limit the restrictions which a company's articles may place on the right of transfer. The articles may give the directors power to refuse to register a transfer in any specified cases, for instance, where calls are in arrear, or where the company has a lien on the shares, and some such provisions are usually inserted. Commonly the articles provide that the directors may decline to register any transfer of a share (not being a fully paid share) to a person of whom they do not approve, and may also decline to register any transfer of shares on which the company has a lien. The articles in many cases go far beyond this. They may prohibit, for example, the transfer of a share to any person who is not a member of a specified class, or provide, as they often do in private companies, that before transferring to an outsider the intending transferor must first offer the shares to the other members and give them a right of pre-emption.

Article 44(1) provides that the directors may in their **absolute discretion** without assigning any reason refuse to register any transfer of shares to **a person of whom they shall not approve**. It is clear at least from the language used that the discretion is exercisable in respect of any transfer of shares, be it from member to member or member to non-member and the directors may refuse to register any transfer to a person (whether a member or not) of whom they do not approve. This construction is in fact supported by *In Re Dublin North City Milling Company* [1909] IR 179 where it was held that where the directors are given absolute discretion to refuse to register **any** transfer of shares (as in Article 44(1) in the instant case) that article is always construed so as to apply to every new proposal for a transfer of shares and the fact that a transferee is already registered as a member makes no difference. The relevant article in the *Dublin* case reads:

> The directors, on behalf of the company, **may decline to register any transfer of shares** not in the prescribed form, or whilst the member making the same is either alone or jointly with any other person indebted to the company on any account whatever, **or unless the transferee is approved of by the board**.
> (Emphasis provided)

The Master of the Rolls in *Dublin* said at p. 184:

> My considered judgment is that under these articles the duties of the directors as regards approval or disapproval arise on every fresh transfer of shares, and that, under these articles, the mere fact that the proposed transferee is already a shareholder does not and cannot diminish their powers, or lessen their obligations, 'on behalf of the company,' in respect of 'any transfer of shares.'

Another thing to remember with regard to this type of cases is the principle involved in the exercise of the discretion given to the board of directors and to what extent the Court should interfere with the exercise of the discretion. Here the discretion conferred by Article 44(1) is by its language absolute. In *Kesar Singh v. Sepang Omnibus Co. Ltd.* [1964] 30 MLJ 122 Ismail Khan J (as he then was) had a similar Article of Association of a company posed before him. The article there read as follows:

> The right of members to transfer their shares shall be restricted as follows:
>
> (a) No share shall be transferred to a person who is not a member so long as any member or any person selected by the directors as one whom it is desirable in the interests of the company to admit to membership is willing to purchase the same at the fair value.
>
> (b) The directors may in their absolute and uncontrolled discretion refuse to register any proposed transfer of shares.

The learned Judge in *Kesar Singh* found that the directors acted in good faith, in the interests of the company and with due regard to the shareholder's right to transfer his shares. The learned Judge then came to the conclusion that the registration of the transfer of the said shares was properly refused. At p. 123 the learned Judge said:

> The principles to be applied in cases where the directors are given by the Articles of Association of a company a discretion with regard to the acceptance of shares are set out in the case of *Re Smith & Fawcett, Ltd.* [1942] 1 All ER 542.

In this context it may be useful to reproduce the speech of Lord Greene in *Re Smith & Fawcett Ltd.* which appears at p. 543:

> The principles to be applied in cases where the Articles of Association of a company confer a discretion on directors with regard to the acceptance of transfers of shares are, for the present purposes, free from doubt. They must exercise their discretion *bona fide* in what they consider - not what a Court may consider - to be in the interests of the company, and not for any collateral purpose. They must have regard to those considerations, and those considerations only, which the articles upon their true construction permit them to take into consideration. In construing the relevant provisions in the articles, it is to be borne in mind that one of the normal rights of a shareholder is the right to deal freely with his property and to transfer it to whomsoever he pleases... The right, if it is to be cut down, must be cut down with satisfactory clarity. **It certainly does not mean that articles, if appropriately framed, cannot be allowed to cut down the right of transfer to any extent which the articles on their true construction permit.**
> (Emphasis provided)

In *Mohan a/l Paramsivam v. Sepang Omnibus Co. Sdn. Bhd.* [1989] 1 MLJ 247 the learned Judge there, Siti Norma J was confronted with a somewhat similar problem as George J in this case. In *Mohan* the question was whether the Court should interfere with the discretion of the board of directors and order rectification of the register because the board of directors had unanimously decided to reject the transfer as the transfer would affect the bumiputra equity in the company. The learned Judge there dismissed the application holding that the directors' refusal to register the share transfer was based on the composition of the shareholders and the percentage of their holdings as bumiputra and non-bumiputras and it cannot therefore be said that the directors had exercised their decision *mala fide*.

The learned Judge here purported to follow the rationale *In the Matter of Tahansan Sdn. Bhd*. However, if one looks at the written judgment of Chan J in that case the distinction is clearly drawn because what the Judge found there was that the problem:

> ...is more imagined than real. The question whether there is a possibility of losing the licence or both the licences is purely an academic one. That that is so is because I have already ordered a winding up on the just and equitable ground. The company is in liquidation. They do not need the licences any more. It did not matter a lot if they were cancelled.

In the present case here it is clearly stated in the cross-examination of the managing director of the company that at the material time the non-Malaysian shareholding of the company was more than 51% and that there was a breach of the condition of the manufacturing licence under the 1975 Act. It was also made clear that the application for the extension of the exemption was refused by the government. There was thus a real likelihood of the appellant company losing its manufacturing licence if the registration was allowed.

We are of the view that the learned Judge in *Mohan* adopted a more correct approach to the function of the Court in an application to seek the Court's discretion to rectify the register of member of a company.

The Court should not interfere with the proper exercise of discretion of the board of directors conferred by the Articles of Association to refuse registration for the well being of the company. Indeed the Court should be slow to question the exercise of the discretion in the absence of evidence that the board of directors had acted *mala fide*.

For the above reasons we allow the appeal with costs here and below. Deposit to be refunded to the appellant.

Also found at [1991] 1 CLJ 12